IN THE

Supreme Court of the United States

OCTOBER TERM 1941

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., Petitioner, against SECURITIES AND EXCHANGE COMMISSION, Respondent.	No.....

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

Opinions of the Courts Below.

The opinion of the District Court is found in the record at pages 30-38.

The majority opinion of the Circuit Court of Appeals (per Augustus Hand, J.) appears in the record at pages 46-52. It has not been reported, having been handed down in the Circuit Court of Appeals for the Second Circuit on June 6, 1941.

The dissenting opinion of Swan, J., in the Circuit Court of Appeals appears in the record at pages 52-53.

II

Jurisdiction.

The decree of the Circuit Court of Appeals for the Second circuit, sought to be reviewed, was filed on June 23, 1941.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as last amended by the Act of June 7, 1934, Chapter 426, 48 Stat. 926; 28 U. S. C. A., Section 347(a).

III

Statement of the Case.

A full statement of the case has been given under the heading "A" in the attached petition and, in the interest of brevity, is not repeated at this point.

IV

Specifications of Errors.

I. The Circuit Court of Appeals erred in finding that defendant has violated Section 5(a) of the Securities Act of 1933.

II. The Circuit Court of Appeals erred in finding that defendant engaged in selling unregistered securities issued by the Chinese Government.

III. The Circuit Court of Appeal erred in finding that defendant solicited offers to buy the securities "for value".

IV. The Circuit Court of Appeals erred in finding that the alleged solicitation of defendant "broadly speaking was for the issuer in connection with the distribution of the bonds".

V. The Circuit Court of Appeals erred in finding that defendant acted as "an underwriter".

VI. The Circuit Court of Appeals erred in reversing the decree of the District Court with directions to deny the defendant's motion to dismiss and to issue the injunction as prayed for in the bill of complaint.

V

Argument.

SUMMARY.

POINT I. The decision of the Circuit Court of Appeals, that the defendant is an underwriter, within the meaning of that term as defined in the Securities Act of 1933, is contrary to the plain words used in the Act, and to the construction thereof by the Courts and the Commission.

POINT II. The construction placed upon the Securities Act of 1933 by the majority of the Circuit Court of Appeals is erroneous.

POINT III. Should the Commission be entitled to relief, resort should be had to diplomatic intervention, rather than to the injunctive process.

POINT I

The decision of the Circuit Court of Appeals, that the defendant is an "underwriter", within the meaning of that term as defined in the Securities Act of 1933, is contrary to the plain words used in the Act, and to the construction thereof by the Courts and the Commission.

We deem it desirable to point out to the Court certain fundamental considerations which we believe the Court should have in mind in considering the question presented by this petition.

First, *there is and can be nothing to prevent the Chinese Government from selling the bonds in China.** In this case all bonds are sold in China.

Second, *no individual is or can be prohibited from purchasing bonds from the Chinese Government in China.* The facts in the instant case clearly show that all purchases of bonds are made in China by agents of the individual purchasers.

Third, *neither the defendant nor the Committee is an agent in this country of the Chinese Government.*

Fourth, the activities of the Committee in urging others to buy the bonds are entirely distinct from its activities as agent for prospective purchasers and must be so considered. These activities must not be confused.

Fifth, all sales of bonds take place in China.

Sixth, the majority of the Circuit Court of Appeals have apparently misapprehended just what facts were contained in the agreed statement of facts entered into between counsel for the parties. In the majority opinion reliance was placed upon the erroneously assumed fact that five separate consent injunctions were obtained against other Chinese benevolent associations, under similar circumstances. This, said the Court, showed "a broad acquiescence in the Commission's interpretation of the Statute" (R. 53). There is nothing in the record to indicate that five consent injunctions were obtained against other Chinese benevolent associations nor is there any evidence as to the facts and circumstances under which the decrees were consented to. What is more, the facts and circumstances in those cases were entirely different and bear no resemblance to those in the present case.

Inasmuch as these cases were never made part of the agreed statement of facts, counsel for the petitioner were much surprised that the attorneys for the Commission re-

* Throughout the argument, whatever italics there are, are those of the petitioner, unless otherwise indicated.

ferred thereto in their brief. In view of the importance which the Circuit Court of Appeals attached to the finding, that there had been "a broad acquiescence in the Commission's interpretation of the Statute", we venture to stress to this Court this serious error.

In this action the Commission sought to enjoin the defendant from certain acts and practices which are alleged to violate Section 5(a) of the Act, which reads as follows:

> "Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> "(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or
>
> "(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

This section does not apply to all transactions in unregistered securities. Certain types of transactions are specifically exempted from the prohibitions of this section by Section 4(1), which provides in part as follows:

> "Section 4. The provisions of Section 5 shall not apply to any of the following transactions:
>
> "(1) Transactions by any person other than an issuer, underwriter or dealer;"

Since it is not claimed that defendant is either an issuer or a dealer and since, in fact, it is neither (R. 35), unless defendant is an "underwriter", the provisions of Section 5(a) are not applicable to it and the action must fail.

Used in its technical sense, the term "underwriter" was, prior to the adoption of the Act, defined to mean one who for a commission undertook to see that an issue of se-

curities was disposed of to the public at a price and to purchase such part of the issue as might not be taken by the public. As used in a popular sense, the term was also defined loosely to mean one who purchased all of an issue of securities and resold it for his own account to the public. In the technical sense, the underwriter acted under a contract or agreement with the issuer; in the popular sense, the underwriter purchased for himself and marketed the securities for his own account. In either sense, the term implied certain relationships between the underwriter and the issuer.

In the definition of the term which is contained in Section 2(11) of the Act, both the technical and popular definitions have been included. This section, insofar as it is material to the issue here, reads as follows:

> "The term 'underwriter' means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking."

It is clear in the present case that defendant has not "purchased from an issuer, with a view to, * * * the distribution of any security"; that is, defendant is not an underwriter in the popular sense of the term (R. 35). Nor can there be any contention that it is a person who "participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking".

Accordingly, the only question here involved is whether defendant "*sells for an issuer* in connection with, the distribution of any security"; i.e., is an underwriter in the technical sense. The determination of this question depends in turn on the determination of the questions (1) whether defendant "sells", and (2) if so, whether it "sells for an issuer".

A. Defendant's activities do not constitute "sales".

It must be clearly apparent that under any ordinary definition of the word "sell" defendant's activities do not constitute sales.

The term "sell" has been defined in Section 2(3) of the Act as follows:

> "The term 'sale', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or *solicitation of an offer to buy,* a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter."

The only portion of the foregoing definition that can have any application here is the clause "solicitation of an offer to buy". A mere reading of the definition in connection with the facts of the case should be enough to demonstrate that no other provisions of this section could under any circumstances be applicable.

In the first place, defendant does not "attempt or offer to dispose of * * * a security", because it has no security to dispose of either by ownership or by the existence of any relationship with the issuer which would permit it to make such disposition.

In the second place, defendant does not contract to sell or dispose of a security (R. 35). As the learned District Court says in its opinion (R. 36):

> "The words 'attempt or offer to dispose of' a security connotes authority from the issuer to consummate the transaction, and in an effort to bring the defendant within that phase of the definition set forth in Section 2(3) of the Act the Commission begs the question in its reply brief."

Its activities in urging purchasers to buy the bonds are purely voluntary on its part and made only on its own initiative. It is not an agent either of the Government or

of the respective purchasers in so urging. In delivering funds to the Bank for individual purchasers, defendant merely acts as the former's intermediary, doing for the former what they could unquestionably do for themselves without in any way violating the Act.

Do defendant's activities involve "a solicitation of an offer to buy"?

Although at first blush one might perhaps answer "yes", since it is undisputed that defendant urges all Chinese to buy the bonds, that is, asks them to make an offer to buy them, a careful analysis shows that it was never contemplated that the Act should be so broadly applied. The definition of the term "sale" is discussed in H. R. Rep. No. 85 (73rd Congress, 1st Session) where it is pointed out what practices the words "solicitation of an offer to buy" were intended to cover—namely, the preventing of dealers from making offers to buy, between the filing of the registration statement and its effective date.

> "The term 'sale' or 'sell' is defined broadly to include every attempt or offer to dispose of a security for value. It includes within the definition of 'sale' an offer to buy, *thereby preventing dealers from making offers to buy between the period of the filing of the registration statement and the date upon which such a statement becomes effective.* Otherwise, the underwriter, although only entitled to accept such offers to buy, after the effective date of the registration statement, could accept them in the order of their priority and thus bring pressure upon dealers, who wish to avail themselves of a particular security offering, to rush their orders to buy without adequate consideration of the nature of the security being offered."

In discussing Section 5 of the Act with respect to activities of underwriters and dealers during the twenty-day waiting period, the Federal Trade Commission, the Commission's predecessor, in Securities Act of 1933, Release No. 70, November 6, 1933, referred to the foregoing report

and confirmed its interpretation of the meaning of the Act, saying:

> "This period, says the House Report, contemplates a change from methods of distribution lately in vogue which attempted complete sale of an issue sometimes within one or at most a few days. Such methods practically compelled distributors, dealers, and even salesmen as the price of participation in future issues of the underwriting house involved, to make commitments blindly.
>
> "During the waiting period, as well as prior thereto, Section 5 of the Securities Act makes it unlawful for the issuers, underwriters, and dealers (to whose transactions the Act is generally applicable) to make an offer to buy or to sell a security—always remembering that 'sell' carries within it the conception expressed in Section 2(3) of an offer to sell or a solicitation to buy. The same section also makes it unlawful to transmit any prospectus (the central feature of which under Section 2(10) is the fact that it offers a security for sale) relating to a security during this period prior to the effective date of a registration statement. The purposes of these sections as related to this particular problem are obvious. *Dealers are not to be solicited to buy the security until a registration statement is in effect;* nor are they to offer to buy such security—an injunction made necessary by the fact that otherwise priority of application during the waiting period might be made the basis for priority of allotment."

From these two statements it is perfectly clear that the clause "solicitation of an offer to buy" in the definition of the word "sell", was included solely for the purpose of preventing the circumvention of the twenty-day waiting period provided by the Act, by the establishment of priorities by an underwriter based upon orders obtained by it from, or submitted by, dealers prior to the expiration of such period.

The conclusion is inescapable that defendant's activities do not constitute *solicitations of offers* to buy within the meaning of the Act.

B. Defendant is not selling "for an issuer".

If it is assumed for the purpose of argument that defendant's activities in urging others to buy the bonds constitute "sales", defendant is an underwriter only if it sells the bonds "for an issuer".

It seems clear that the use of the phrase "for an issuer" in conjunction with the word "sells" indicates the intention of Congress by this definition to define as an "underwriter" a person who comes within the meaning of that term as it was technically defined prior to the adoption of the Act; that is, that an underwriter is one who contracted with an issuer to sell to the public its securities and to take up such balance as might not be sold to the public. This is even more clear when it is realized that the clause now under consideration is the correlative of a clause defining as underwriters those who prior to the adoption of the Act came within the popular definition; that is, persons who have purchased "from an issuer with a view to, * * * the distribution of any security".

Only those who "sell *for an issuer*" are underwriters.

Accordingly, as used in the Act, the term "underwriter" involves the existence of a contractual or agency relationship between the issuer and the person alleged to be an underwriter. To hold otherwise would negative the existence of any exemption under Section 4(1).

The Commission has recognized that such a relationship must exist. In *Matter of Canusa Gold Mines, Limited*, Securities Act of 1933, Release No. 1507, July 15, 1937, the Commission held that an issuer was liable under Section 12(1) of the Act in connection with the sale of its stock prior to the filing of a registration statement therefor, on the ground that a certain firm of brokers which sold such stock was an underwriter thereof. It appeared that directors and principal stockholders of the issuer loaned their stock to the brokers under an arrangement providing for the sale thereof to the public and the remission to the issuer of 25¢ per share from the proceeds of such sale.

The Commission discussed the evidence at length and held that it had been established that such transaction had taken place with full knowledge of the issuer and as part of an arrangement between the issuer, its stockholders and the brokers. The Commission held that the stock was sold "for" the issuer, that the brokers were in fact agents of the issuer and hence that they were underwriters of the stock. The Commission said:

> "An 'underwriter' is defined by Section 2(11) of the Securities Act of 1933 as 'any person who * * * sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking * * *.' It is clear that the sales by Outlook Investments, Ltd. of stock loaned to it by the officers, directors and stockholders of the registrant pursuant to a tripartite understanding between these persons, the underwriter and the issuer constituted sales 'for' the issuer, Canusa Gold Mines Limited, in connection with the distribution of its stock. The fact that 25¢ per share of the proceeds of all such sales was paid direct to the registrant or applied to its account is conclusive that Outlook Investments, Ltd. was acting for the registrant in selling the loaned shares. Therefore, there can be no question that this distribution of the borrowed stock through the mails and in interstate commerce was effected by Outlook Investments, Ltd. *as an agent for the registrant* and *hence with respect to these borrowed shares it was an 'underwriter' as defined in the Act.* Unless some exemption under Section 3 of the Act is applicable to the securities sold, all transactions by an underwriter are subject to the registration requirements of Section 5(a) of the Securities Act. No such exemption is claimed in this case. Accordingly, all sales thus made by Outlook Investments, Ltd., directly and indirectly, through the mails or by the use of instrumentalities of interstate or foreign commerce seem to have been in direct violation of Section 5(a)(1) of the Act. Likewise the delivery of shares through these means for the purpose of sales or after sale would appear to have violated Section 5(a)(2). These transactions accordingly resulted in civil liabilities

> under Section 12(1) of the Act. Since these sales were effected for the benefit of, and under an arrangement with, the issuer who received 25¢ per share sold, it is our opinion that the civil liabilities thus created may extend to the issuer."

This states the law as we believe it to be, namely, that to be an underwriter one must act "for an issuer"; that is, as an agent of the issuer.

In the present case, defendant has no contractual or agency or other relation with the Chinese Government or any of its agencies (R. 35).

The fact that defendant assists prospective purchasers of the bonds by taking funds to the bank and executing applications for the purchase of bonds does not change defendant's status in any way. This the Commission conceded. It is doing merely what such purchasers could unquestionably do themselves without coming within the prohibitions of the Act.

Since defendant is not an underwriter, it has the right of any individual to express its opinion concerning, and to urge the purchase of, the bonds. Congress never intended the result for which the Commission contends, namely, that a person who neither has any connection with an issuer nor sells for his own account is nevertheless an underwriter because such person urges others to purchase from the issuer the latter's securities.

The Act clearly was intended to apply to persons who are "underwriters" as that term was defined either technically or popularly at the time of the adoption of the Act. Defendant is not an underwriter under that definition or under the definition contained in the Act. To find defendant is an underwriter emasculates the exemptions provided in Section 4(1).

POINT II

The construction placed upon the Securities Act of 1933 by the majority of the Circuit Court of Appeals is erroneous.

By considering its language and the decisions under it we have shown above that the Securities Act cannot be held to apply to the activities of the defendant. We now turn to the construction put upon the statute by the Court below.

The first ground for the holding of the majority opinion of the Circuit Court of Appeals recognizes that if defendant is not an "underwriter", then Section 4 of the Securities Act exempts the actions of defendant (R. 50). Looking to the definition of "underwriter" in Section 2(11) that we have already discussed, the Court concedes that the only words which are susceptible of covering the actions of the defendant are "any person who * * * sells for an issuer in connection with the distribution of any security". Although the Court can state no authority contrary to the position the Commission itself took in *Matter of Canusa Gold Mines, Limited*, supra, that the words "for an issuer" mean acting *as an agent of the issuer*, it goes on to hold that "sell for an issuer * * * ought to be read as covering continual solicitation, such as the defendant was engaged in." This is not only plainly against the ordinary meaning of the words used and contrary to the position of the Commission itself, but as was said by Judge Swan in his dissenting opinion in the Circuit Court of Appeals, "gives no meaning to the words *for an issuer*". Judge Swan goes on to show the lengths to which this construction of the majority opinion will lead by pointing out that "a single newspaper editorial, published without instigation by the Chinese Government and merely urging the purchase of the bonds in the name of patriotism, would make the

newspaper an 'underwriter'." (R. 52-53). That Congress could have intended such a result is scarcely conceivable.

As was said in *Wight* v. *Heublein*, 238 Fed. Rep. 321 (C. C. A., 4th Cir.):

> "There are few surer tests in statutory construction than to observe whether the interpretation contended for exposes the statute itself to ridicule; and to find in this act a requirement that * * * is absurdity itself, and the argument must go to this extent."

The other ground relied upon by the majority of the Circuit Court of Appeals (R. 51) is equally unwarranted by the provisions of the Securities Act. At the beginning of its opinion on this point, the Court held that "Section 4(1) was intended to exempt only trading transactions between individual investors with relation to securities already issued and *not to exempt distributions by issuers*". No authority is cited for this proposition either from decisions or from Congressional Reports and it is altogether unjustified on the face of the words used in that section of the Act or elsewhere. A little further on there appears the statement "even if the defendant is not an issuer, underwriter or dealer", it was participating in a transaction with an issuer, to wit, the Chinese Government. However that may be, Section 4(1) does not exempt from the provisions of the Act

> "transactions by any person other than an issuer, *or one participating in a transaction with an* issuer, an underwriter or dealer."

It has never been a rule of statutory construction to graft on a whole group of words to broaden a plain meaning of a statute.

Finally, the Court goes on to hold that the activities of defendant in connection with the offers to buy the bonds by the Chinese in the United States were only a part "of the complete transaction" which included the offers them-

selves, the transmission of the offers to China, their acceptance and the transmission of the bonds to the purchasers. This is true enough, just as every human act can be broken down into the mental impulse that directs the muscular action and the muscular contraction which carries out the commands of the mind, but not so the conclusion that the Court derives from this fact, namely, that Section 4(1) "does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of security issues". That is to say, Section 4(1), it was held, does not apply to exempt component parts of the entire issuing transaction, which component parts are consequently included in transactions by issuers, underwriters and dealers.

The fallacy in this position lies in the fact that the issuer, the underwriter and the dealer are themselves cogs in the chain of issuing and delivering securities to the particular purchaser and since the statute provides that these specific cogs are not exempt, then surely along the old rule of statutory construction "inclusio unius exclusio alterius", other participants in the issuing transaction are exempt. It would have been easy enough for Congress to have provided words to cover other participants in the issuing transaction had it seen fit to do so, so that Section 4(1) would have exempted

> "transactions by any person other than an issuer, underwriter or dealer, *and other persons involved in the process of issuing securities*".

And why indeed would Congress have provided for any exempted transactions *at all* had it not intended to have only certain participants in the whole span of issuing securities bound by the provisions of the Act. Here again, there is no authority in the words of Section 4(1) nor in any court decision or the Congressional Reports to suggest in any way this construction, which does violence to the plain meaning of the words used in the Act, and to the plain scheme of the statute.

The holdings of the majority opinion in the Circuit Court of Appeals can only be based upon the unjustifiable idea of giving an elastic construction to the language of an Act, which the Court apparently believed Congress made intentionally broad in view of the importance of regulating the sale of securities. However that may be, "the provisions of the Act are clear and free from ambiguity" (R. 38) and the Securities Act can no more be broadened in its scope, and its plain language departed from, than any other Act of Congress. It is supererogatory to point out that it is not and never has been proper for the courts to usurp the function of the legislators, with the purpose of reaching even the most allegedly desirable results, and that whenever lower courts have attempted to do so, this Court has prevented these attempts, pursuant to the basic division of functions between the legislative and the judicial branches of the government.

As was said in *Iselin* v. *United States*, 270 U. S. 245:

> "What the [Commission] asks is not a construction of a statute but in effect an enlargement of it by the Court * * *. *To supply omissions transcends the judicial function.*" (*United States* v. *Detroit First National Bank*, 234 U. S. 245.)

If a particular course of conduct requires regulating in the eyes of the Securities and Exchange Commission, it is for the Commission to address itself to Congress for the power to do so. It is not for the courts arbitrarily to confer that power upon it, by distorting the plain meaning of words in an Act of Congress. It is the duty of Congress, which it cannot delegate, to determine policies and regulate the rules and regulations which administrative bodies must follow. Art. 1, Secs. 1 and 7, U. S. Constitution; *Schechter* v. *United States*, 295 U. S. 495, at 530. The provisions of the Act are clear and unambiguous. Transactions by all persons except issuers, underwriters and dealers are excluded from its scope. The further

limitation of the exemptions provided in Section 4(1) completely emasculates that section, and pushes the statute to cover situations which we have shown could not possibly have been intended by Congress to be thus regulated.

POINT III

Should the Commission be entitled to relief, resort should be had to diplomatic intervention, rather than to the injunctive process.

Even assuming that the Act could be held applicable in this situation, it is obvious that the ordinary rules of International Law as developed by the courts of this country should be applied in this situation, namely, that injunction or other relief cannot be granted against a foreign government and that the proper procedure would be as indicated in the opinion of the District Court, when it says (R. 37) "the channels of diplomacy are open through the Department of State".

The Chinese Government is represented in this country, and its authorized representative should be requested, if necessary, to file a registration statement. As was said in the opinion of the District Court, "no attempted backdoor entrance to the [Courts] can be permitted to compel such a result" (R. 38).

CONCLUSION

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers in order that the errors into which the Circuit Court of Appeals for the Second Circuit has fallen may be corrected and substantial justice be done and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals for the Second Circuit and finally reverse it.

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August 4, 1941.